



Department of the Treasury  
Internal Revenue Service  
TE/GE EO Examinations  
1100 Commerce Street  
Dallas, Texas 75242

501.07-00

Date: October 10, 2010

TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

Number: **201338050**  
Release Date: 9/20/2013

Taxpayer Identification Number:  
Form:

ORG  
ADDRESS

Tax Year(s) Ended:  
Person to Contact/ID Number:  
Contact Numbers:  
Telephone:  
Fax:

Dear :

In a determination letter dated June 8, 19XX you were held to be exempt from Federal income tax under 501(c)(7) of the Internal Revenue Code (The Code).

Based on recent information received, we have determined you have not operated in accordance with the provisions of Section 501(c)(7) of the Code. Accordingly, your exemption from Federal income tax is revoked effective January 1, 20XX.

This is a final adverse determination letter with regard to your status under 501(c)(7) of the Code.

We previously provided you a report of examination explaining why we believe revocation of your exempt status is necessary. At that time, we informed you of your right to contact Taxpayer Advocate, as well as your appeal rights. On November 16, 20XX you signed Form 6018-A, Consent to Proposed Action, agreeing to the revocation of your exempt status under section 501(c)(7) of the Code.

You are required to file Federal income tax returns for the tax period(s) shown above. If you have not yet filed these returns, please file them with the Ogden Service Center within 60 days from the date of this letter, unless a request for an extension of time is granted, or unless an examiner's report of income tax liability was issued to you with other instructions. File returns for later years with the

appropriate service center indicated in the instructions for those returns.

You have the right to contact Office of the Taxpayer Advocate. Taxpayer Advocate assistance is not a substitute for established IRS procedures, such as formal Appeals process. The Taxpayer Advocate cannot reverse a legally correct tax determination, or extend the time fixed by law that you have to file a petition in a United States court. The taxpayer Advocate can, however, see that a tax matter that may not have been resolved through normal channels gets prompt and proper handling. You may call toll-free 1-877-777-4778 and ask for Taxpayer Advocate Assistance. If you prefer, you may contact your local Taxpayer Advocate at:

If you have any questions, please contact the person whose name and telephone number are shown at the beginning of this letter.

Sincerely,

Reviewer's Name  
EO Exam Reviewer



TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

Department of the Treasury  
Internal Revenue Service  
TE/GE EO Examinations  
100 South Clinton Street Room 1109

Syracuse, NY 13261

December 14, 2010

ORG  
ADDRESS

**Taxpayer Identification Number:**

**Form:**

**Tax Year(s) Ended:**

**Person to Contact/ID Number:**

**Contact Telephone Number:**

**Contact Fax Number:**

Dear

We have enclosed a copy of our report of examination explaining why we believe an adjustment of your organization's exempt status is necessary.

If you accept our findings, please sign and return the enclosed Form 6018-A, *Consent to Proposed Action*. We will then send you a final letter modifying or revoking your exempt status.

If we do not hear from you within 30 days from the date of this letter, we will process your case on the basis of the recommendations shown in the report of examination and this letter will become final. In the event of revocation, you will be required to file Federal income tax returns for the tax period(s) shown above. If you have not yet filed these returns, please file them with the examiner as soon as possible, unless a report of income tax liability was issued to you with other instructions. File returns for later tax years with the appropriate service center indicated in the instructions for those returns.

In lieu of Letter 3610

If you do not agree with our position, you may appeal your case. The enclosed Publication 3498, *The Examination Process*, explains how to appeal an Internal Revenue Service (IRS) decision. Publication 3498 also includes information on your rights as a taxpayer and the IRS collection process. Please note that Fast Tract Mediation Services referred to in Publication 3498, do not apply to Exempt Organizations.

If you request a conference, we will forward your written statement of protest to the Appeals Office and they will contact you. For your convenience, an envelope is enclosed.

If you and Appeals do not agree on some or all of the issues after your Appeals conference, or if you do not request an Appeals conference, you may file suit in the United States Tax Court, the United States Court of Federal Claims, or the United States District Court, after satisfying procedural and jurisdictional requirements as described in Publication 3498.

You may also request that we refer this matter for technical advice as explained in Publication 892, *Exempt Organizations Appeal Procedures for Unagreed Issues*. If a determination letter is issued to you based on technical advice, no further administrative appeal is available to you within the IRS on the issue that was the subject of the technical advice.

You have the right to contact the office of the Taxpayer Advocate. Taxpayer Advocate assistance is not a substitute for established IRS procedures, such as the formal appeals process. The Taxpayer Advocate cannot reverse a legally correct tax determination, or extend the time fixed by law that you have to file a petition in a United States court. The Taxpayer Advocate can, however, see that a tax matter that may not have been resolved through normal channels gets prompt and proper handling. You may call toll-free, 1-877-777-4778, and ask for Taxpayer Advocate Assistance. If you prefer, you may contact your local Taxpayer Advocate at:

In lieu of Letter 3610

If you have any questions, please call the contact person at the telephone number shown in the heading of this letter. If you write, please provide a telephone number and the most convenient time to call if we need to contact you.

Thank you for your cooperation.

Sincerely,

Nannette M. Downing  
Director, EO Examinations

Enclosures:  
Publication 892  
Publication 3498  
Form 6018-A  
Report of Examination  
Envelope

In lieu of Letter 3610

Form <b>886A</b>	Department of the Treasury - Internal Revenue Service <b>Explanation of Items</b>	Schedule No. or Exhibit
Name of Taxpayer <b>ORG</b>		Year/Period Ended 20XX12

**LEGEND**

ORG - Organization name      XX - Date      City - city      State - state  
Island - island

**ISSUES:**

1. Whether ORG (Organization) is a social club as described under Internal Revenue Code (IRC) 501(c)(7).

**FACTS:**

The organization is exempt from income tax pursuant to Internal Revenue Code (IRC) § 501(a) because it is described as a social club in IRC § 501(c)(7).

The organization was incorporated in the city of City, State of State for the purposes of the following, "to act as a neighborhood improvement association and as such, to own, hire and lease lands and buildings upon the island of Island and in other places necessary for the betterment of the neighborhood or neighborhoods of members and such to build, repair and maintain streets and ways, build, repair and maintain private water supply systems, carry on the operation of social clubs, societies, places of recreation, sport, amusement and instruction for the benefit and entertainment of its members and their nominees, build, repair and maintain wharves or landings for the use of its members and buy, sell, maintain and rent boats of all sorts to its members and their nominees, to conduct any of its corporate objects in any of the states of the United States and have 1 or more officers therein; provided, however, that nothing herein contained shall be construed to authorize the corporation to transact business in any state contrary to the provisions of the Laws of such state".

The original application for exemption, dated June 8, 19XX, stated that "The organization was formed to coordinate mutual interests of several members of the summer colony at Island, State, by a pooling of caretaking and utility services and by providing social functions".

"Each year the corporation leases property at ORG containing various buildings and facilities, including those for water and electricity, which it operates for the benefit of some of its members. For rent the corporation agrees to maintain the property and pay a sum equal the real estate taxes and premiums for fire and liability insurance on the premises. It employs a caretaker who does work for the benefit of the corporation and also for the benefit of the individual members. Members pay an annual membership fee of \$\$ and an assessment fee if any major repairs are needed that year. The individual work is specially billed to the members on a cost basis. Members are also assessed \$ to take care of general expenses".

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The care taker and three other employees supply maintenance and repair services for the organization and individual member homes. Traditional activities that the employees do include hauling and launching member boats, supplying fresh water on the docks, taking care of all of the maintenance for the dock area, boat house, water system, gas house, picking up trash for the organization and maintaining the swimming pool and the tennis court areas. Prohibited non traditional activities that the organization does includes picking up all the trash for member homes, supplying water service to member homes and performing maintenance and repairs on member homes. The organization also supplies water service for its use and also for individual members use for their homes. The members pay on a per household basis. There are 14 or 15 users in all including the organization. During the year under audit the organization received the following prohibited non traditional revenue from these home owners. These non traditional activities have been conducted for many years. \$ in labor, \$ for material used for maintenance & repairs on member homes, \$ rubbish revenue for picking up trash at their homes, \$ for water service.

The homes are personally owned by the members. When a member needs repairs done on their home they contact the organization which schedule's an appointment to provide the service. Upon completing the repairs, the member is billed. Payment for such repairs are paid directly to the organization.

**LAW:**

**IRC 501(c)(7)** provides that clubs are exempt from tax that are organized for pleasure, recreation, and other non-profitable purposes, substantially all of the activities of which are for such purposes, and no part of the net earnings of which inures to the benefit of any private shareholder.

**§1.501(c)(7)-1. Social clubs**

(a) The exemption provided by section 501(a) for organizations described in section 501(c)(7) applies only to clubs which are organized and operated exclusively for pleasure, recreation, and other non-profitable purposes, but that clubs are exempt from tax that are organized for pleasure, recreation, and other non-profitable purposes, substantially all of the activities of which are for such purposes, and no part of the net earnings of which inures to the benefit of any private shareholder.

**§1.501(c)(7)-1(b)** of the regulations provides that a club which engages in business, such as selling real estate, is not organized and operated exclusively for pleasure, recreation, and other non-profitable purposes and is not exempt under section 501(a) of the Code.

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**Santa Barbara Club v. Commissioner, 68 T.C. 200 (1974).** "In that case, the Tax Court had to determine whether a social club's status as a tax-exempt organization under IRC 501(c)(7) could be revoked because the club sold liquor to its members for consumption away from the club's premises. In determining whether the activity was substantial, the Tax Court based its decision on the amount of gross receipts generated from the liquor sales, which was in excess of 25% of gross receipts from all sources." Thus, the Tax Court held that the organization was not exempt because the activity did not further any social club purposes, was recurrent, and the gross receipts were in excess of 25% of total gross receipts.

**Revenue Ruling 58-589, 1958-2 CB 266** states;

"where a club engages in income producing transactions which are not a part of the club purposes, exemption will not be denied because of incidental, trivial or nonrecurrent activities such as sales of property no longer adapted to club purposes. *Santee Club v. White*, 87 Fed. (2d) 5. In order to retain exemption a club must not enter into outside activities with the purpose of deriving profit. Section 1.501(c)(7)-1 of the Income Tax Regulations and *Santee Club v. White*, supra. If such income producing activities are other than incidental, trivial or nonrecurrent, it will be considered that they are designed to produce income and will defeat exemption."

**Revenue Ruling 68-168, 1968-1 CB 269** reads:

"A nonprofit organization that leases building lots to its members on a long-term basis is not exempt from Federal income tax under section 501(c)(7) of the Internal Revenue Code of 1954."

In the text of Revenue Ruling 68-168 it states "Although the revenues from this activity are derived from the organization's members only, the revenues are not raised from the members' use of recreational facilities, or in connection with the organization's recreational activities. The conduct of such real estate activity, whether with members only or with the general public, is not incidental to or in furtherance of any purpose covered by section 501(c)(7) of the Code. Accordingly, the organization does not qualify for exemption from Federal income tax under that section."

**Revenue Ruling 68-535, 1968-2 CB 219, (Jan. 01, 1968):**

"A social club that regularly sells liquor to its members for consumption off its premises is not entitled to exemption under section 501(c)(7) of the Code."

In the text of Rev Ruling 68-535 it states:

"the regular sale of liquor under the circumstances in the instant case is a service to the members that is neither related to nor in furtherance of a social club's exempt purposes. Since such activity is neither social nor recreational, the club is not operated exclusively for pleasure, recreation, and other nonprofitable purposes within the meaning of section 501(c)(7) of the Code."



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Accordingly, the social club described above is not entitled to exemption from Federal income tax under section 501(c)(7) of the Code.”

**Revenue Ruling 63-190, 1963-2 CB 212**

“A nonprofit organization (not operated under the lodge system), which maintains a social club for members and also provides sick and death benefits for members and their beneficiaries, does not qualify for exemption from Federal income tax either as a social club under section 501(c)(7) of the Internal Revenue Code of 1954.”

**Revenue Ruling 75-494, 1975-2 CB 214, (Jan. 01, 1975)**

**Qualification; homeowner associations as social clubs.--**

“A club providing social and recreational facilities, whose membership is limited to homeowners of a housing development, will be precluded from qualifying for exemption under section 501(c)(7) of the Code by owning and maintaining residential streets, enforcing restrictive covenants, or providing residential fire and police protection and trash collection service.”

**Rev. Proc. 71-17, 1971-1 C.B. 683**, sets forth guidelines for determining the effect of gross receipts derived from nonmember use of a social club's facilities on the club's exemption under Code §501(c)(7). In §3.02 this Revenue Procedure defines the term ‘total gross receipts’. Total gross receipts means receipts from normal and usual activities of the club including charges, admissions, membership fees, dues, and assessments. Excluded for this purpose are (a) initiation fees and capital contributions, (b) interest, dividends, rents, and similar receipts, and (c) unusual amounts of income such as amounts derived from nonrecurring sales of club assets.

Public Law 94-568, amended §501(c)(7) to provide for exemption from federal income tax clubs organized for pleasure, recreation, and other non-profitable purposes, substantially all of the activities of which are for such purposes and no part of net earnings of which inures to the benefit of any private shareholder.

The Committee Report (S. Rep. No.94 - 1318, 94<sup>th</sup> Cong., 2<sup>nd</sup> Sess.1976) that accompanied P.L. 94-568, provides congressional intent to the limitations on revenue from outside membership. The report reads in part as follows:

“It is intended that a social club, or any other organization exempt under Code §501(c)(7), may receive the full 35-percent amount of its gross receipts from investment income sources (reduced by any amount of nonmember income)... in the case where a social club permits nonmembers to use its club facilities and receives 15 percent of its gross receipts from these nonmember sources, it may receive only up to 20 percent of its income from investment sources.”

**TAXPAYER'S POSITION:**

The taxpayer has agreed to revocation of their tax exempt status as of January 1, 20XX.

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### **GOVERNMENT'S POSITION**

Based on the facts of the examination, we conclude that you do not meet the requirements for exempt status under section 501(c)(7) of the code. Section 501(c)(7) of the Code provides that a club be organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes is exempt from Federal income tax, provided no part of its net earnings inures to the benefit of any private shareholder. Maintenance and repair services provided to members for work done on their personal residences is a private benefit to its members. This organization, in carrying out its purposes in the manner described above, is not being operated exclusively for pleasure and recreation of its members. Accordingly, it does not qualify for exemption under section 501(c)(7) of the Code.

The organization did over % of prohibited non traditional exempt activities. According to Revenue Ruling 58-589, 1958-2 CB 266, an organization that performs incidental, trivial or nonrecurrent activities, exemption will not be denied. These prohibited non traditional activities were not trivial or incidental and they have occurred for many years. In the tax court case Santa Barbara Club v. Commissioner, 68 T.C. 200 (1974), non exempt activity was % and exempt status was revoked.

Revenue Ruling 68-535 and Revenue Ruling 63-190 (stated above), are two revenue rulings where non traditional exempt activities were involved and exempt status was revoked. Even though these activities were done by members, these activities were neither social nor recreational, are considered nontraditional activities and if substantial and recurring, tax exempt status should be revoked. Exempt social clubs are not permitted to receive income from activities not conducted in furtherance of their exempt purposes. Revenue ruling 71-17, Pub law 94-568 and the report that accompanied P.L.94-568, (S. Rep. No.94 - 1318, 94<sup>th</sup> Cong., 2<sup>nd</sup> Sess.1976), give further evidence that income from the active conduct of businesses not traditionally carried on by these organizations is not authorized and exemption should be revoked.

### **Conclusion:**

Accordingly, we conclude that you do not meet the requirements for exempt status under section 501(c)(7) of the code and propose to deny your exemption under that section. We have determined you fail to qualify for exempt status under any other subsection of IRC 501(c). After the proposed revocation becomes final, you will be responsible for filing F1120s in the future.